Back to the roots: On the origins of the Fed's independence

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Abstract:

This note considers the foundations of the Federal Reserve Board's independence. Its origins are shown to reside in the American political philosophy, under which independence is an essential working condition for a perennial democracy.

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"The institution of delegated power implies that there is a portion of virtue and honour among mankind, which may be a reasonable foundation of confidence."
(The Federalist No. 76)

1. Introduction

The present consensus within the economists' community favours the choice of an independent central bank. This kind of management of monetary affairs is a signal of how important a society considers monetary stability is (see Crowe and Meade, 2007). In other words, while this function was in the hands of the government, with independence, the central bank becomes the guarantor of the monetary (and, beyond that, of the social) order. But this of course depends on the supporting political consensus. Given the redistributive impact of inflation and, more broadly, of monetary policy, the choice of a degree of independence for a society's central bank has to be politically backed by a political consensus (at least, by a clear majority) to be sustainable.[1]

How deep is this political consensus in the case of the Federal Reserve Board? This question was raised at an early stage, and still agitates more than a politician's mind and, by way of consequence, more than a central banker.[2] Since the beginning, the Fed has

[1] Sustainability in our context can be thought of as anchoring private agents' inflation expectations, to avoid people fleeing the currency offered by the central bank (Gresham's law).
[2] Among the latest episodes, see Jim Bunning (Kentucky Senator) attacking the Fed's policy of the 1990s and 2000s: "(…) the Fed is asking for more power, but the Fed has proven they cannot be trusted with the power they have. They get it wrong, do not use it, or stretch it farther than it was ever supposed to go in the first place. (…)Giving the Fed more power is like giving a neighborhood kid who broke a window playing

tried to assert her independence: The very first annual report of the Federal Reserve Board indicates that the Fed addressed an inquiry to the Attorney General to confirm her independence (see Federal Reserve Board, 1915). Interestingly, in his reply, the Attorney General confirms the deep roots of the Fed's independence, both administratively, and politically, insisting notably on the multi-partisan consensus supporting the delegation of power to the Fed. Note that this episode makes it clear (1) that independence has to be understood as independence from the government (both legislative and executive branches)[3] and (2) that the political support concept relies on a multi-partisan consensus which, indirectly, supposes that the issue does not divide the electorate.

It is true that the Fed's powers and tasks have evolved since she was set up, and that such an evolution has sometimes been criticized, even among academics, notably because an independent central bank extending the reach of her instruments may overstep the initial delegation of power (see, for example, Reagan, 1961). Such a fear may exist, but only if the roots of the delegation of power are not deeply stuck into a society's power-sharing arrangements.

In the case of the Fed, we will argue here that such fears are probably excessive, due to the deep foundations of the Fed's independence. As shown below, these foundations are not purely economic, but derive from an order of explanations which has its origin in the American political philosophy. We will therefore return to the American constitutional thinking, and particularly to that of the Founding Fathers, to show how this contains the philosophical and political justification for delegating the management of monetary affairs to an independent authority. We will also show that, in the mind of the founders, far from creating a “democratic deficit”, delegating monetary policy is an essential element in upholding democracy. As such, the political consensus supporting the independence of the Fed is probably stronger than the actors themselves may sometimes feel.

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baseball in the street a bigger bat, and thinking that will fix the problem…" (reported by CentralBankNews, July 2008.)

[3] Of course, independence from the government implies questions of accountability, which lie out of the scope of this article (see e.g. Howells, 2009, for a recent discussion of the issue).

As such, this article explains the endogenous character of the shape of monetary institutions, unearthing the conditions for a polity to accept (and, thereafter, support) an independent central bank. These conditions are shown to lie in the consistency of political and monetary institutions, a contention already made by Moser (1999) and Farvaque (2002). Such a consistency, however, necessarily relies on a view of how the executive and legislative powers have to be shared and balanced. As we show, the case of the Federal Reserve proves the point because, since she was established as a central bank it has been clear that she should be free from political and external influences (Timberlake, 1993).

The perspective adopted is thus different from those of the principal-agent (Drazen, 2000) or the economic consensus (Forder, 2005). While the former offers economic arguments to adopt an independent central bank, its late emergence in the 1980s does not enable to understand why some central banks (e.g. the Fed or the Bundesbank) were established independent before the economic literature offered some support. The latter is useful in explaining how the economic case for independent central banks spread worldwide. However, this perspective hits the same limit to understand to which degree a society can grant its central bank some independence.

The Federal Reserve almost offers a quasi-experimental case because of its relatively late foundation in a country whose political institutions had been defined over a century before. This forced the legislators to argue on how the new institution would (or not) be consistent with the established political order.[4]

The article is structured as follows: section two presents the literature background on the pros and cons of central bank independence and shows that a blank has to be filled between the economic and the political spheres. The following section details the original argument that supports a restraint on the executive power of the sovereign. Section 4

4 Jeong et al. (2009) also justify focusing on the Fed because of it being a "stronghold against inflationary policies in the United States and thus the world economy" (p. 473).

shows how, in the minds of the authors of *The Federalist*, the power of passions also had to be reigned in, while Section 5 goes onwards, showing how independence and democracy can be brought together, and notably in the case of the Federal Reserve Board. The last section contains concluding remarks.

2. Background: the pros and cons of central bank independence

Academically, the argument for insulating central banks from the political process can be traced back to Strotz (1955), and Kydland and Prescott (1977). But the streamlined model of Barro and Gordon (1983, a and b) gave the argument a stronger appeal, notably by focusing the discussion on monetary policy, before Rogoff's (1985) demonstration of the benefits of a conservative central banker. From this literature, it emerged that a central bank whose preferences are more inflation averse than the society's ones can increase the credibility of a low inflation regime.

Though it did not emerge in Rogoff (1985), the fact that central bank independence can be a "free lunch" (Alesina and Gatti, 1995) attracted a lot of attention. Not only would central bank independence tame inflation, but also without any loss in terms of output volatility (Alesina and Summers, 1993). This "no trade-off" (or "free lunch") feature of central bank independence gave it a strong appeal, as it is not so often that a policy measure inflicts no pain on the economy. This rare feature attracted a lot of empirical studies that were devoted to assess the impact of central bank independence. The broad consensus, built from studies as influential as Grilli et al. (1991), Cukierman et al. (1992), was later confirmed by, e.g. Brumm (2000, 2006).

Such a flow of studies, however, did not leave the consensus unscathed. First, the underlying model was criticized as too simple, notably due to the omission of fiscal policy. Blake and Weale (1998), for example, showed that the inflation bias may lead to over-expansionary fiscal policy, even under (and maybe due to) central bank independence. Di Bartolomeo and Pauwels (2006) also showed that the properties of the equilibrium supporting the case for central bank independence are relatively fragile.

Second, the exogenous character of central bank independence was also questioned. While Posen (1993) showed the convergence of interests between some interest groups and the institutionalization of central bank independence, the presence of an "inflation culture" as a society's supporting feature was exhibited by Hayo (1998). Daunfeldt and de Luna (2008) showed that price stability is often obtained before the central bank receives a higher degree of independence, while a link between the demographic structure and inflation was also exhibited (Farvaque et al., forthcoming). Though they raise doubts about the true importance of central bank independence to tame inflation, this reform was largely adopted, and the consensus has spread (Forder, 2005), even though some now consider the consensus to be flawed and call central bank independence a "rational fiction" (McNamara, 2002).

All in all, then, the case for central bank independence probably has to be nuanced. The contrasted evidence and the focus on the potential endogeneity of independence can only lay the stress on the need for a deeper understanding of the roots of independence. Even though independence can no longer be thought of as a panacea, we have to understand why it sometimes has such an impact on inflation and inflation expectations.

Our claim in this paper is that McCallum's (1995) critique has to be taken seriously: as an independent central bank is made independent by politicians, who always retain the possibility of giving away this independence, one can not think central bank independence as an institution in isolation from the rest of the political institutions. Hence, central bank independence is not only rooted in the monetary policy area, but also in the political arena, where the terms of the delegation contract were first designed and then had to be enforced. And one can even assert that, by making the denying more transparent (as, politicians are generally more closely observed than central bankers), delegation is more than the answer to a purely functional problem. There may even be a democratic appeal in central bank independence, if the political institutions are consistent and can support it.

To progress on this question, we thus have to understand the philosophy of the institutions that accept independence as a condition of democracy. Hence, to use the words of McNamara (2002, p. 55), even if "delegation does not occur in a political vacuum", we still need a theory establishing how independence can be accepted by a society, and then influence it afterwards. As we will show, such a theory can be found in the Founders' views, supporting the argument of an independent central bank as a fully-fledged political body.

3. Controlling the executive power

The justification for the independence of central banks was originally legal, and depended on a certain political philosophy[5]. This political philosophy is what led the drafters of the American Constitution, when they met at the 1787 Convention. In accordance with this tradition, the legitimacy of independence is essentially achieved as a response to two kinds of fears.

First, the capacity for trouble, which lies in the executive power, creates a need to control it. This adds to a fear, expressed by those who have since then been called the Founding Fathers, of losing a freedom – dearly won – following demagogic manipulations, leading to abrupt movements in opinion. Mistrust of the executive and the fear of instability thus laid the foundations of the American Constitution and, further, provided the key to legitimating delegated powers, primarily monetary power.

Executive power is a relatively recent invention which may be attributed to Machiavelli, who was the first to make "necessities" a guiding principle of the constitutional order.

[5] The reader will therefore understand that, in the sense of Grilli et al. (1991), the analysis will be more focused on political independence than on economic independence.

This does not mean that the executive power as such did not exist before, but that this executive was then "disproportionate (…), rejects any constitutional limit and seizes power for itself (...)" (Mansfield, 1989, pp – 125-126). Machiavelli's challenge was then to integrate this executive into a stabilised[6], but strictly human political order[7]. It would be up to other thinkers to establish the executive power and the balance of powers within an ideal Constitution.

Nevertheless, the executive remains marked by the stamp of history, a violent history as it happens, and the aim of modern constitutions is indeed to harness this power[8], to put it at the service of the interests of the people. The whole problem therefore comes from the fear that the executive may hijack the Constitution to serve its own interests. Two options then open up.

The first option is to control the executive power by means of the legislative power, by allowing the latter to monitor the actions of the former. In this respect, the legislative (i) represents the people, (ii) it defines the law in accordance with the mandate that it has been granted (whether this one is mandatory or representative matters little here) and (iii) makes the executive power enforce the law, under supervision from the people's delegates. In this idea of the separation of powers, it is obvious that the executive power does not have the freedom to change the law[9].

It is easy to agree that this vision of the constitutional order is not really suitable for the delegation of powers. It is therefore understandable that the principle of central bank independence has had some problems in making its way in Europe, where this initial option prevailed. The British case is typical: the Bank of England (founded in 1664, and

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[6] The objective is to maintain the current regime, not to establish an "optimal" utopian regime, of the "ideal city" type.

[7] One has to remember that Machiavelli served under a temporal power at a time when appealing to God was still the foundation of authority. One of his major changes was therefore to separate temporal and spiritual powers.

[8] This argument is, for example, present in the American debates and in the discussions taking place in the French Constituent Assembly, even if there is a more explicit reference to it in the former experience (Elster, 1991).

[9] In any case, not by its own decision: "The legislature can discuss laws but cannot act; the executive can act but cannot change established and existing laws". (Mansfield, 1989)

which was one of the first central banks to be established) only obtained its instrumental independence late (in 1997), but still not its formal independence. Monetary policy, as a part of the executive power, remained subject to legislative power until very recently (and, in a formal manner, the constraint remains, despite the recent relaxation of government controls).

On the contrary, the second constitutional option fully accepts the particular strength of the executive power, but tries to define mechanisms to control it. According to this idea, the instruments of power that can check the power have to be created. This task was fulfilled during the American Revolution by the 1787 Convention, which brought together the drafters of the future American Constitution. This event provides us with a prototype of rational decision-making concerning the adoption of a Constitution, as well as a new kind of founding text, which was called the *Federalist*.

This collection of texts written by the drafters of the Constitution (these include the first and fourth presidents, Washington and Madison respectively), aims at explaining the text and justifying its adoption by the founding States. These Americans were indeed aware of creating a regime that was democratic, certainly, but above all republican. In order to do so, they therefore had to overcome three obstacles specific to the United States: impose a *parliamentary* regime on a *large* population, living in a *large* territory (cf. *The Federalist*, no. 14). This was achieved through representative (and no longer mandatory) mandate, and the creation of a strong executive, these two powers being part of a republican regime.

The difficulty is, of course, entirely to reconcile these three features in a way that allows the country's political stability, and therefore its continuity to be guaranteed. As Mansfield (1989) states, the task of the *Federalist's* political science is to show that it is possible to republicanise a strong executive.

Historic circumstances more than likely played a role in the founders' desire to create a new constitutional model, by rejecting that of the United Kingdom - or its theorisation by Montesquieu, who mades this country his model for a free government. But their political genius also has to be praised. They understood that the country's democratic aspiration should not be thwarted, and in particular that they could rely, as Montesquieu did, on the aristocracy, because it would have a particular virtue. They also did not wish to retain a sovereign executive (in all senses of the "sovereign" term), and preferred to combine a constitutional executive with the principle of popular sovereignty. The founders would consequently create institutions which would allow this new ambition to be realised, and in a lasting manner.

Thus, and in an apparently paradoxical manner, the founders first established a strong executive. These extended powers given to the executive power have two advantages: (i) they should enable decisions to be made quickly and efficiently at the highest level[10]; (ii) they are also a way to thwart the legislative branch, which, in general, dominates the political life of democracies, at the cost of a potential instability (see below). The founders thereby created a presidential role, and gave it important powers (notably the right of veto).

Then the founders, mindful of the potential abuse of the executive power, tried to avoid the risk of tyranny. The strengths of the executive power then became its weaknesses. Hence the length of the mandate, which was conceived, not as a way of favouring the personal exercise of power but, on the contrary, as a way of making the executive accountable to the electorate (cf. Mansfield, 1989). The main reminder will therefore come from the people themselves, whether through their representatives or directly. By increasing the visibility of power, its holder is made accountable.

The Supreme Court will represent another reminder, if necessary, to bring the executive power back on the right track. The executive, the regulatory authorities and the judiciary are therefore organised in such a way that none of these prevails over the other. In a way that reminds economists of Mundell's triangle of incompatibility, the American Constitution thereby resolves a kind of triangle of incompatibility by combining a strong

[10] These powers given to the executive again testify to the influence of Machiavelli's thinking on American institutions (demonstrated by Pocock, 1975).

executive, controlled by a sovereign legislature, with relations between the two of them mediated by a judicial power that neither the one nor the other are likely to completely control. The executive is therefore controlled, which reduces the risk of autocratic abuse and which solves one of the main fears of the founders[11]. The risk is therefore to subject the whole construction to another risk, that of instability.

4. Controlling the instability of passions

The founders believe that instability arises from an outburst of passions. They say that the risk comes from the fact that a passion can unite a group of individuals. If they succeed in organising themselves, they can succeed in imposing the achievement of their *desiderata* on other citizens (potentially less mobilised). Passions can therefore be reinforced and give rise to factions, which will seek political representation, and therefore a place in the institutions[12]

> *"by a faction, I understand a number of citizens, whether amounting to a majority or a minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community." (The Federalist no. 10)*

Consequently, due to the factions' actions, it is the whole of the political system that might be destabilised, and the freedoms acquired in the Revolution could be reduced. The exercise of passions must therefore be avoided. According to the terminology in force at the time of the Foundation, only virtue alone allows corruption arising from passions to

[11] A fear that cannot be resolved by turning to the English philosophy of John Locke, for example. This major reference of the time on the separation of powers did not in fact distinguish the judicial power from the executive, which Montesquieu clearly did (cf. Mansfield, 1989).

[12] In the *Federalist* (no. 10) we find a very strong awareness that the factions will sometimes rely on the divergence of economic interests, the "unequal distribution of wealth". More exactly, the factions which emphasise the diversity of economic interests, and on the other hand those which are based on economic inequality stand out (Ackerman, 1991) For a theorisation of these phenomena, see Olson (1966), Becker (1983), and more recently, Grossman and Helpman (2001).

be checked[13]. Virtue was then the first quality required, therefore sought, for leaders of the future American Republic, all the more so as the Founding Fathers noted, despite themselves, that the people is increasingly subject to passions.

The architecture of the institutions should therefore forsee future outbursts of demagogy in order to avoid, *ex ante*, the flood of passions sweeping them away, as they swept away other regimes in the past. The law should therefore offer for a method for the regulation of conflicting interests.

A first mode of regulation consists of representation[14]. The people are not led to debate themselves, (as they would do in an ideal – or small – republic), but to *delegate* their power to their elected representatives. Hence, the people are the source of power but do not in any way have the authority to make laws. The people are therefore strongly encouraged to select from their members those who are the most able (in the mind of the founders: the most virtuous), to guarantee that the public interest and the stability of the regime is respected.

This confidence in the legislator may be surprising, now that the role of lobbies in shaping legislation has been proven. Moreover, as they are delegated by the people, their representatives will probably be affected by the same passions as they are. Therefore, apparently, the American Constitution only makes the problem go back a level, without resolving it completely.

Only apparently, because, as Ackerman (1991) shows, since the Foundation the Americans have had a two stage process which allows them to curb passions and limit their destabilising impact: what he characterises as a “dualist democracy”. According to this, one can distinguish two kinds of decision in American political life: the rare ones made directly by the people and the more common ones, made by the government. The challenge of democracy comes into play when the government tries to backtrack on its

[13] Cf. Pocock (1975, chap. XV).
[14] Another way of regulating passions would be to limit freedoms, which the Founders obviously opposed.

fundamental commitments (implied: taken by the people) by means of a common decision.

Ackerman (1991) details the way in which this dilemma is solved in a peaceful and institutionalised manner by the intervention of a third party, which is embodied in the Supreme Court. More precisely, the Constitution provides for a certain number of conditions so that it can be modified: three quarters of the States should agree, the assemblies have the monopoly on discussions (but share the initiative with the President), and any modification is necessarily an amendment added to the original text. In the event of abuse (as happened in the early years, as reviewed in, for example, Ackerman, 1991, chap. III), a role as an arbiter is therefore entrusted to the supreme judicial body, *via* the constitutionality check. The Court therefore has the role to safeguard the public interest, which it protects from passions spread by the different factions.

The people have therefore spoken for a first time, by adopting the Constitution. The passions and factions game must now be prevented from challenging this founding agreement of the Republic (and beyond this, of the country itself):

> *"where the will of the legislature, declared in its statutes, stands in opposition to that of the people, declared in the Constitution, the judges ought to be governed by the latter rather than the former." ." (The Federalist no. 78)*

In other words, in the case of conflict between the desire of elected representatives and the founding texts, the judge's duty is to ensure that the basic law is respected.

Of course, the judges also risk being drawn into the flood of passions. The impartiality of the constitutionality check should therefore be guaranteed. This is where the idea of independence comes into play.

5. Independence as a democratic choice

Justification for independence is provided in article no. 78 of the *Federalist*. This is probably the first theorisation of the choice of independence, according to an argument that is both rigorous and pragmatic. Independence appears to be a necessity, a way of countering the instability produced by changes in preferences.

However, it is not compatible with democracy unless the people can state their preferences. Independence aims at allowing them to confirm how their preferences vary, following a period of information and reflection through, for example, a political campaign leading to an election at the national level. This process gives the electors a period of reflection, which can lead to a constitutional amendment. There should therefore be a solemn - and legal - act, so that the founding text can be modified. The required solemnity of the necessary act aims, of course, at moderating the fervour of passions and at verifying the temporary or permanent character of changes in public preferences. In this argument, independence occurs as the means of guaranteeing the "courage" of the judges (which would be achieved, for example, by the unlimited length of mandate of judges in the Supreme Court). These should in fact ensure a counterweight to the instability of passions by reminding electors about their recent choices, and why they made them.

Of course, this belief in the virtues of independence can only be understood if one combines this quote with the one which we have quoted at the head of this note: the judges' independence can only establish the confidence of the people in its institutions if these are virtuous, which the appointment process in particular tends to guarantee.[15]

However, the key aspect of our remarks is the legitimization, by the Founding Fathers, of the principle of independence. Far from corrupting democracy, this then proves to be one

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[15] However, the appointment process is outside the limited scope of this note. We would simply recall that these are nominated for life, which strengthens their independence because their mandate will, in all probability, cover several presidential and parliamentary mandates. On the prestige that judges in the Supreme Court enjoy, see for example "Daylight, magic, and the Supreme Court", *The Economist*, 16 December 2000.

of the conditions for the existence (in the sense of stability and durability) of the American democratic republic. As we will now show, the same argument applies in monetary matters, when the American nation endows itself with a central bank.

5.1. The Federal Reserve: past – present

The theory of factions set out in the *Federalist* links political instability to economic inequalities. Thus, not only has political philosophy had an economic impact, because it influenced the method of managing monetary affairs, but the economy was, previously, an integral part of institutional choices: Madison (one of the main drafters of the Constitution and the *Federalist*) thus formulated the constitutional principles in order to prevent the consequences of high inflation (such as the redistribution of wealth taking place during the strong inflation of the Foundation period).[16]

For one thing, the Founding Fathers were aware of monetary disturbances and of the redistributive effects of inflation. The monetary aspects were, originally, part of Parliament's responsibilities, but expenditure and resources were not entrusted to the same hands. From the first article of the Constitution (section 8), onwards, Parliament is given the responsibility of regulating the value of money (in practical terms: to define its metallic counterpart), in order to avoid "*debasement*", one of the forms of seigniorage) by the authorities.

The Founders thus sought to separate monetary management from the vicissitudes of political life, too aware, as they were, of the importance of economic aspects in political debates (cf. Hetzel, 1997). A final indication, if one were needed, of this desire to reduce the risks of monetary abuse is provided by the ban on the Federal States issuing money (article 1, section 10).

[16] This interpretation is that of the historian Jack Rakove, 1996, O*riginal Meanings, Politics and Ideas in the making of the Constitution*, Alfred Knopf, p. 44; quoted in Hetzel (1997).

Nevertheless, strictly speaking, at the time of the Foundation there was no central bank in the United States of America. Parliament carried out the functions, without however succeeding in achieving the monetary stability the drafters of the Constitution so eagerly wanted (cf. Faust, 1996).

After a turbulent monetary history, particularly in the issuing of paper money (see for example Friedman, 1992, or Gorton, 1999), one had to wait until 1907, a year of banking panic, to see the emergence of a consensus to support the creation of a central bank. The framework was set in 1913, and would be the subject of many clarifications up to 1935 (cf. Eichengreen, 1992, Miron, 1989).

Jeong et al. (2009) have studied the role of interest groups at the time of the foundation of the Fed. They clearly show that the writing of the statutes is the result of a political compromise among competing interest groups. They have also shown that the debates opposed two political currents, populist and progressive, the latter viewing central bank independence as a way to create a neutral bureaucracy able to resist party politics and being instrumental in increasing the independence of the Fed from the President. This progressive current itself dates back to the Jeffersonian tradition (Forder, 2003).

The debates at the time of the foundation of the Fed clearly opposed camps whose roots can be traced back as far as the Foundation era. This clearly supports our argument as, even if the Fed was the result of a political compromise, this compromise was moulded by legislators whose ways of thinking were framed in the Foundation period.[17]

The challenge of the creation of the Federal Reserve is therefore as much to combat the influence of the banking sector, one of many factions (See e.g., Timberlake, 1993 or Meltzer, 2004), as to protect the new central bank from political pressures.[18] Her

[17] It has to be restated that our objective is not to look at the debates which took place when the American central bank was founded, but to show the continuity of inspiration, in political philosophy, when the American nation has to choose the statutes of the institution to which one chooses to give monetary responsibility.

[18] For Forder (2003), financial interests were predominant in defining the independence of the Fed, while both our reasoning and Jeong et al.'s (2009) results offer a more nuanced view of the prevalent interests.

independence is therefore conceived as independence with regard to the executive, which took some liberties with its monetary functions at the end of the 19th century. Interestingly, then, the way the debates were framed shows the continuity between the two periods, the Foundation of the Republic and the founding of the Fed.

The central bank was then given a role within the American institutions that was more or less identical to that exerted, in the judicial field, by the Supreme Court: it should be quite independent in relation to Parliament and the President (who nominates the chairperson of the Federal Reserve) without being able to fully free itself, particularly in a period of crisis.[19]

It is noteworthy to observe that this configuration continues to be relevant (since 1935, the legislative framework which includes the Federal Reserve has hardly evolved) and, above all, that it remains a reference, even an implicit reference, for those responsible for the American monetary policy. A former vice-president of the Fed therefore emphasises democratic legitimacy, but also the accountability of independent central bankers, in a text, (intended for economists) surprisingly marked by the political philosophy that we mentioned:

> "*We obtained our political legitimacy from men who appointed us, and they in turn got it the old-fashioned way – directly from the voters. That is how it should be (…) To me, public accountability is a moral corollary of central bank independence. In a democratic society, the central bank's freedom to act implies an obligation to explain itself to the public. Thus independence and accountability are symbiotic, not conflicting. Accountability legitimises independence within a democratic political structure.*" (Blinder, 1996, p. 12)

[19] Moreover, the search for such a compromise between independence and responsiveness explains why the Chairman's mandate of the *Board of Governors* of the Federal Reserve is 4 years (14 years for the other members of the *Board*), compared to 15 years for the head of the Government Accounting Office and to a life mandate for the judges of the Supreme Court.

In other words, if central bankers are not elected, this is in fact because it does not need doing. The only thing that matters is the moment when it was decided to change their mission, or their statute, which could only happen at the end of a long and costly process, intended to prevent any untimely disruption. However, this independence requires a counterpart, in the form of the central banker's accountability.[20]

Seeking to elect central bankers directly would therefore be counter-productive, and would mean political instability in the monetary sphere. In this theoretical context, there could be a difference between the public's preferences and those of the central bank, but this situation is typical of the short-term. As for the long-term, this is characterised, of course, by these two groups of preferences coinciding, as they coincided at the founding (constitutional) stage, or as they will coincide when there is a fundamental revision (see above and Ackerman, 1991).

According to this argument, independence does not conflict with democratic culture because its adoption is part of a political process, of a rational choice by the voters: "shielding monetary policy, foreign policy or audiovisual policy from the political sphere is in itself a political act" (Elster, 1993).

6. Conclusions

While it may have been forgotten by the prevailing consensus, central banks do not operate in a political vacuum. The foundation of central bank independence is indeed, then, that of a reflection in political philosophy, which finds its expression at the constitutional level from the birth of the American Constitution onwards, about two centuries ago. The underlying political mechanism is as follows: (1) a strong executive risks perverting democracy, thus it is necessary to control it. It is mainly up to the representatives of the people to carry out this role, but these, like the people themselves,

[20] The Fed is not only the warrant of price stability but also (notably) of full employment. That these objectives may at times have been conflicting can be seen as an element of the political compromise from which the Fed emerged. It can also be considered as an element of the central bank's accountability.

are likely to experience passions which risk challenging the institutional edifice; (2) in order to reduce the risks of institutional disruption it is necessary to establish a constitutionality check which, to be impartial, should be independent.

The principle of independence does not therefore pervert democracy. On the contrary, it guarantees its continuity. Far from the conflagrations of the political scene, temporary changes, partisan confrontations, the authority, to whom a fragment of power has been delegated, could carry out the mission which it was entrusted with by the legislator, without risking a break in continuity.

The lesson this story teaches for today is that the political foundations of a central bank can not be ignored, something that should be recognized by the drafters of new central banks in failed states, and even more probably in prospective monetary unions, be it in Africa, Asia, or the Middle East. Not considering the consistency of the whole set of institutions, of which the central bank, could make it "possible that an independent central bank is impossible" (Coleman, 2001).

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